Supreme Court, U.S.
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Docket Number _____

SUPREME COURT OF THE UNITED STATES

Ancil N. Payne, Jr., and Mary E. Payne,

Petitioners,

v.

Commissioner of Internal Revenue,

Respondent

On Petition for Writ of Certiorari to the
United States Court of Appeals
for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

Ancil N. Payne, Jr., and Mary E. Payne, Pro Se

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(Petition prepared by Ancil N. Payne, Jr.)

QUESTIONS PRESENTED FOR REVIEW

Does a person whose indebtedness is discharged receive gross income if that person has, at the time of the discharge, already repaid to the lender all money that that person had borrowed?

Does a person whose indebtedness is discharged receive gross income if that person has, at the time of the discharge, already repaid to the lender all money that that person had borrowed and, in addition, money amounting to interest at a reasonable rate?

Does the exclusion from gross income provided by 26 U.S.C. section 108(e)(5) apply when an indebtedness for charges for the use of borrowed money (all such borrowed money having already been repaid) is reduced by agreement of the borrower and lender?

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OFFICIAL AND UNOFFICIAL REPORTS OF OPINIONS AND ORDERS ENTERED IN THIS CASE

Payne v. Commissioner, T.C. Memo. 2008-66, 95 T.C.M. (CCH) 1253 (2008) (Docket No. 21634-06).

Payne v. Commissioner, 357 Fed. Appx. 734, 104 A.F.T.R.2d 2009-7793, 2010-1 U.S.T.C. ¶ 50,132 (8th Cir. 2009) (Case No. 08-2396).

JURISDICTIONAL STATEMENT

The judgment sought to be reviewed was entered by the United States Court of Appeals for the Eighth Circuit on December 22, 2009. A petition for rehearing timely received by that court on February 5, 2010, was denied March 5, 2010.

This Court, pursuant to 28 U.S.C. section 1254, has jurisdiction to review by writ of certiorari the judgment of the United States Court of Appeals for the Eighth Circuit entered December 22, 2009.

RELEVANT STATUTORY PROVISIONS

The statutory provisions involved in this case are these:

26 U.S.C. section 61(a):

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

. . .

(12) Income from discharge of indebtedness;

. . . .

26 U.S.C. section 108(e):

For purposes of this title --

. . .

(5) If--

(A) the debt of a purchaser of property to the seller of such property which arose out of the purchase of such property is reduced,

(B) such reduction does not occur--

(i) in a title 11 case, or

(ii) when the purchaser is insolvent, and

(C) but for this paragraph, such reduction would be treated as income to the purchaser from the discharge of indebtedness,

then such reduction shall be treated as a purchase price adjustment.

. . . .

STATEMENT OF THE CASE

Late in 2004, the petitioner husband, Ancil N. Payne, Jr., and MBNA America, N.A., agreed that Ancil N. Payne, Jr.'s, payment of $4,592 would satisfy, or legally pay in full for less than the full stated balance of $21,270.69, his indebtedness on a credit-card account. At that time, the amounts (including the final payments in settlement) paid on the account by Ancil N. Payne, Jr., exceeded the amounts borrowed (as cash advances and as payments to third parties on Ancil N. Payne, Jr.'s, behalf). Ancil N. Payne, Jr., maintains that there is a very high degree of probability that the amounts paid exceeded the amounts borrowed so greatly as to amount to a payment of interest at a constant rate of seven per cent per annum, compounded monthly, or, from a different standpoint, at a variable rate equal to the rate imposed by 26 U.S.C. section 6621 for interest on underpayments of tax, compounded monthly.

MBNA America, N.A., issued to Ancil N. Payne, Jr., a Form 1099-C showing a cancellation of indebtedness of $16,678 ($21,270.69 minus $4,592, rounded to a whole-dollar amount). On Ancil N. Payne, Jr.'s, and Mary E. Payne's joint income tax return for 2004, timely filed in 2005, the amount of

$16,678 was not reported in income. A statement was attached to the return, disclosing the amount of $16,678, and explaining the taxpayers' reasons for maintaining that this amount was not includable in gross income.

The respondent Commissioner, pursuant to 26 U.S.C. section 6212(a), on July 24, 2006, mailed to the petitioners a notice of deficiency of $5,410 in income tax for 2004, a deficiency based on the position that the amount of $16,678, explained above, was includable in Ancil N. Payne, Jr.'s, gross income. The petitioners timely mailed by registered mail on October 20, 2006, their petition, pursuant to 26 U.S.C. section 6213(a), to the United States Tax Court for a redetermination of the deficiency. On March 21, 2008, the United States Tax Court entered its decision that there was a deficiency of $5,410. On June 17, 2008, the petitioners' notice of appeal to the United States Court of Appeals for the Eighth Circuit was timely filed and docketed in the United States Tax Court. On December 22, 2009, the judgment of the United States Court of Appeals for the Eighth Circuit was entered, affirming the decision of the United States Tax Court. On March 5, 2010, the order of the United States Court of Appeals for the Eighth Circuit was entered, denying the petitioners' (appellants' in the Eighth Circuit) petition for rehearing that had been timely received on February 5, 2010.

The United States Tax Court had jurisdiction pursuant to 26 U.S.C. section 6213(a). The United States Court of Appeals for the Eighth Circuit had

jurisdiction pursuant to 26 U.S. C. section 7482(a), Ancil N. Payne, Jr., and Mary E. Payne being at all relevant times residents of Minnesota.

This case concerns the inclusion or noninclusion of $16,678 in the gross income of the petitioner husband, Ancil N. Payne, Jr. Mary E. Payne is a party solely because she filed an income tax return for 2004 jointly with her husband.

ARGUMENT FOR ALLOWANCE OF THE WRIT

In what circumstances does a discharge of indebtedness produce *income* includable for income tax purposes in a taxpayer's gross income under 26 U.S.C. section 61(a)(12)? That is the primary question presented by this case. Section 61(a)(12) is not self-operative; there are circumstances in which a person's indebtedness is discharged but in which the person does not receive gross income. See S. Rep. No. 1622, 83d Cong. 2d Sess. 14, 1954 U.S. Code Cong. & Admin. News 4621, 4643 (1954); *Commissioner v. Rail Joint Co.*, 61 F.2d 751 (2d Cir. 1932); *Fashion Park, Inc. v. Commissioner*, 21 T.C. 600 (1954) (Reviewed); *Bradford v. Commissioner*, 233 F.2d 935 (6th Cir. 1956) (Stewart, J.).

There are two approaches to this question. One is to answer that a person receives gross income whenever he or she is relieved of a liability (assets are freed) and his or her balance-sheet net worth is

increased. The other looks to what the discharged debtor received for incurring the debt (loan proceeds) and considers whether that receipt would have been includable in gross income were it not for the recipient's promise to repay. If it would have been includable, then the discharge of indebtedness makes no longer valid the reason for not including the borrowed amount in gross income at the time of borrowing, and, as a corrective, the amount of the unrepaid and now never-to-be-repaid debt must be included in gross income at the time of discharge. But, if it would not have been includable, then the discharge of the promise of repayment should have no tax effect.

This analysis of the question is the consensus of much scholarly writing. For a recent notable example, see Zelenak, "Cancellation of Indebtedness Income and Transactional Accounting," forthcoming in the *Virginia Tax Review*. This Court alluded to the theoretical uncertainty of the discharge-of-indebtedness question and the not-clearly-defined role of the "freeing of assets" idea in *Commissioner v. Tufts*, 461 U.S. 300, 310 n. 11 at 311 (1983), a case in which *Rail Joint* and *Fashion Park* were cited, apparently with approval. See 461 U.S. at 309 n. 6. And, indeed, this Court in *Tufts* held that, for purposes of the question of the amount realized for tax purposes when a taxpayer is relieved of a nonrecourse mortgage indebtedness, the determinative fact is the amount received for incurring the indebtedness, not the amount (i.e., the lesser value of the encumbered property) for which the debtor-mortgagor might be said to be juridically

liable. See 461 U.S. at 309-310 and 310 n. 8. In sum, the present case requires a resolution of a question similar, if not complementary, to the question decided in *Tufts*.

This question is important, for the use of credit cards is widespread and settlements and payoff arrangements are likely to be frequent. See the text accompanying note 3 in the forthcoming article of Zelenak, *supra*.

The taxpayers make an alternative argument that the settlement between the taxpayer husband and his credit-card creditor was in substance and in economic reality a restatement of his account at a reduced rate of interest, his account as so restated being repaid in full. In this connection the taxpayers rely on 26 U.S.C. section 108(e)(5), arguing from the holding of this Court in *Dickman v. Commissioner*, 465 U.S. 330 (1984) (*use* of borrowed money is "property" within meaning of 26 U.S.C. section 2501, imposing tax on transfer of property by gift), that the *use* of money is "property" also within the meaning of 26 U.S.C. section 108(e)(5), so that the reduction of an indebtedness arising out of the purchase of that property (i.e., a reduction of an indebtedness for interest, which is the purchase price of that property), if it were otherwise held to give rise to gross income, contrary to the taxpayers' principal argument based on the "loan proceeds" theory, should be treated as a purchase price adjustment under 26 U.S.C. section 108(e)(5) and thus should not give rise to gross income. This argument, which is supported by the Tax Court's similar use of the

Dickman rationale in *Federal Home Loan Mortgage Corp. v. Commissioner*, 121 T.C. 254 (2003) (*use* of money is "property" within meaning of 26 U.S.C. section 167, providing deduction for depreciation or amortization of property), raises an important question concerning the scope and implications of this Court's decision in *Dickman*.

In sum, this case presents questions of great practical importance in view of the probable increasing frequency of settlements of debts, questions of great theoretical importance, and questions about the implications of this Court's decisions in *Tufts* and *Dickman*. In addition, this Court in the exercise of its supervisory power should not ignore the failure of the courts below, despite competent and thorough briefs of both parties, to give any satisfactory explanation of their holdings, or to discuss, or even cite, cases like *Rail Joint* and *Dickman*, which were at the core of the taxpayers' argument.

CONCLUSION

For the reasons stated, this Court should grant a writ of certiorari and should hear and decide this case, reverse the judgment below, and hold that there is no deficiency in the taxpayers' income tax liability for 2004.

Respectfully submitted,

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(petition prepared by Ancil N. Payne, Jr.)

United States Court of Appeals
for the Eighth Circuit

No. 08-2396

Ancil N. Payne, Jr.; Mary E. Payne,
Appellants,

v.

Commissioner of Internal Revenue,
Appellee.

Appeal from the United States Tax Court

[UNPUBLISHED]

Submitted: October 21, 2009

Filed: December 22, 2009

Before MURPHY, COLLOTON, and SHEPHERD,
Circuit Judges.

PER CURIAM.

Ancil Payne and Mary Payne challenge the tax court's [fn 1] decision, after a bench trial, upholding the determination of the Internal Revenue Service (IRS) of their taxable income for the tax year 2004. They concede that in 2004 Ancil paid $4,592 to a bank to settle an undisputed credit card balance of $21,270.69. They argue that the $16,678 discharge of indebtedness did not constitute income, however, because Ancil paid the bank more than he originally borrowed plus a reasonable amount of interest, although less interest than the parties had agreed upon; and even if the discharge of indebtedness was income, it should have been excluded from their gross income as a purchase-price adjustment under 26 U.S.C. § 108(e)(5).

Following careful review, see Campbell v. Comm'r, 164 F.3d 1140, 1142 (8th Cir. 1999) (standard of review for tax court decisions), we conclude that the tax court did not err in upholding the IRS's determination. See 26 U.S.C. § 61(a)(12) (gross income means all income from whatever source derived, including income from discharge of indebtedness); Babin v. Comm'r, 23 F.3d 1032, 1034 (6th Cir. 1994) (where debt owed by taxpayer is discharged, difference between face value of debt and amount paid in satisfaction of debt is includable in taxpayer's gross income under § 61(a)(12)); see also 26 C.F.R. § 1.6050P-1(c) (indebtedness means any amount owed to applicable entity, including stated principal, fees, stated interest, and penalties); Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 148 (1974) (transaction is to be given

tax effect in accord with what actually occurred and not in accord with what might have occurred); Preslar v. Comm'r, 167 F.3d 1323, 1331 (10th Cir. 1999) (§ 108(e)(5) permits taxpayers to reflect debt reduction by adjusting basis of their property rather than recognizing immediate gain as cancellation of indebtedness; § 108(e)(5) applies only to direct agreements between purchaser and seller).

Accordingly, we affirm.

[fn1] The Honorable Harry A. Haines, United States Tax Court Judge.

T.C. Memo. 2008-66

UNITED STATES TAX COURT

ANCIL N. PAYNE, JR. AND MARY E. K. PAYNE,
Petitioners v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 21634-06. Filed March 18, 2008.

Ancil N. Payne, pro se.

Trent D. Usitalo, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

HAINES, Judge: Respondent determined a deficiency of $5,410 in petitioners' Federal income tax for 2004. [fn 1] The sole issue for decision is whether petitioners should have included $16,678 of discharge of indebtedness income on their 2004 Federal income tax return. We hold that they should have done so and therefore sustain respondent's determination.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts, together with the attached exhibits, is incorporated herein by this reference. At the time they filed their petition, petitioners resided in Minnesota.

At the end of 1992 petitioner Ancil N. Payne, Jr. (Mr. Payne), opened a credit card account with MBNA America Bank. Mr. Payne used the credit card to pay hospital bills and receive cash advances during periods of unemployment. By April 26, 2004, Mr. Payne had accumulated $21,407 of credit card debt. At no time did Mr. Payne challenge the accuracy of this amount. Petitioners were not insolvent in 2004, nor did they file for bankruptcy.

By October 19, 2004, Mr. Payne and MBNA entered into an agreement whereby MBNA agreed to accept $4,592 as a full settlement of the account balance of $21,270, payable in installments over 4 months. [fn 2] Mr. Payne made the necessary payments, and MBNA issued him a Form 1099-C, Cancellation of Debt, reporting $16,678 of discharge of indebtedness income.

On petitioners' 2004 Form 1040, U.S. Individual Income Tax Return, filed jointly in April 2005, petitioners did not report any discharge of indebtedness income. Instead, petitioners attached a statement to their return which disclosed that they received a Form 1099-C from MBNA that reported discharge of indebtedness income of $16,678. The statement also explained that petitioners believed

the amount disclosed on the Form 1099-C was not subject to income tax.

Respondent's determination of a deficiency in petitioners' Federal income tax for the taxable year 2004 was attributable to petitioners' failure to report the discharge of indebtedness income. [fn 3]

OPINION

Section 61 generally defines gross income as "all income from whatever source derived". Section 61(a)(12) specifically provides that gross income includes income from the discharge of indebtedness. See also Gitlitz v. Commissioner, 531 U.S. 206, 213 (2001); United States v. Kirby Lumber Co., 284 U.S. 1 (1931). Respondent determined that MBNA's agreement with Mr. Payne to accept $4,592 in full settlement of the undisputed account balance of $21,270 resulted in $16,678 of discharge of indebtedness income to petitioners. Petitioners bear the burden of proving respondent's determination incorrect. [fn 4] See Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

I. Reduction of Purchase Price

Petitioners contend that their settlement with MBNA did not result in the discharge of indebtedness but was rather a retroactive reduction of the rate of interest charged by MBNA and thus a reduction of the "purchase price" of the loans under section 108(e)(5). Although the record does not

indicate that MBNA agreed to retroactively reduce the rate of interest of its loans to petitioners, petitioners have nevertheless painstakingly calculated the various interest rates that applied to their outstanding balances from October 1994 through October 2004 and attempt to show that by the time of their settlement they had paid back all of the principal they had borrowed from MBNA.

Section 108(e)(5) provides an exception to section 61(a)(12) where the buyer of property negotiates with the seller/creditor for a discharge of all or part of the purchase money indebtedness. Commonly such a discharge reflects a decline in the value of the property. The resulting discharge of indebtedness is characterized not as taxable income but in effect as a retroactive reduction of the purchase price. Where, however, the only relationship between the parties is that of debtor and creditor, "The rule of Kirby Lumber is clearly applicable". OKC Corp. & Subs. v. Commissioner, 82 T.C. 638, 647 (1984).

Petitioners argue that the lending of money in a generic credit card transaction constitutes the sale of "property" under section 108(e)(5). Petitioners are mistaken. MBNA effectively lent petitioners money to be used for health care costs and general living expenses. [fn 5] The only relationship between the parties was that of debtor and creditor, and thus section 108(e)(5) does not apply. See OKC Corp. & Subs. v. Commissioner, supra at 647.

II. Discharge of Indebtedness for Interest Payments

Petitioners also allege that no income arises from the discharge of indebtedness for interest payments. In support of this proposition, petitioners reference Earnshaw v. Commissioner, T.C. Memo. 2002-191.

Generally, when a solvent debtor's fixed obligation is reduced or canceled, the amount of the reduction or cancellation constitutes income. Sec. 61(a)(12); United States v. Kirby Lumber Co., supra. In Earnshaw v. Commissioner, supra, we concluded that there had been a legitimate dispute between the debtor and creditor regarding the amount of the debtor's obligation. We held that the taxpayer recognized discharge of indebtedness income from the settlement, but the amount was based on the account balance that the taxpayer admitted to rather than the higher amount the Commissioner alleged. Earnshaw does not stand for the principle that discharge of indebtedness income does not include the cancellation of debt attributable to interest payments.

As no exclusion applies and the amount of petitioners' obligation was clearly fixed, petitioners should have included $16,678 of discharge of indebtedness income in their gross income on their 2004 tax return.

In reaching this holding, the Court has considered all arguments made and, to the extent not mentioned, concludes that they are moot, irrelevant, or without merit.

To reflect the foregoing,

Decision will be entered for respondent.

[fn 1] Unless otherwise indicated, all section references are to the Internal Revenue Code, as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure. Amounts are rounded to the nearest dollar.

[fn 2] Several of these payments had already been made by the time the agreement was formalized.

[fn 3] The deficiency is also based on a greater portion of petitioners' Social Security income becoming taxable and the disqualification of petitioners for the earned income credit. Both of these adjustments stem from the increased gross income petitioners would have as a result of the discharge of indebtedness.

[fn 4] Petitioners do not argue that the burden of proof shifts to respondent pursuant to sec. 7491(a) and that the threshold requirements of sec. 7491(a) have been met. In any event, we decide the issue on the basis of the preponderance of evidence on the record.

[fn 5] Insofar as petitioners used the credit card to buy merchandise, the Commissioner treats debt forgiveness in third-party lender cases as a purchase price adjustment only if the forgiveness is directly related to an aspect of the sale, as where a seller

inflates the purchase price by misrepresentation. Rev. Rul. 92-99, 1992-2 C.B. 35.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 08-2396

Ancil N. Payne, Jr. and Mary E. Payne,

Appellants

v.

Commissioner of Internal Revenue,

Appellee

Appeal from Tax Court, Internal Revenue Service

(21634-06)

ORDER

The petition for rehearing by the panel filed by appellants is denied.

March 05, 2010

Order Entered at the Direction of the Court:
Clerk, U.S. Court of Appeals, Eighth Circuit.

/s/ Michael E. Gans